

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

ANR Pipeline Company

Docket No. RP99-301-030

ORDER ON REHEARING

(Issued November 21, 2001)

ANR Pipeline Company (ANR) and Baltimore Gas and Electric Company (BG&E) filed requests for rehearing of the Commission's August 1, 2001 letter order issued¹ in this proceeding. That order, among other things, accepted service agreements between ANR and the shipper, subject to ANR demonstrating that the service agreements could not be provided under a generally applicable rate schedule developed consistent with other aspects of ANR's tariff. In the alternative, the Commission required ANR to file a revised agreement without the non-conforming provisions. In addition, the Commission directed ANR to explain why the shipper is not currently eligible for a regulatory right of first refusal (ROFR) under ANR's current tariff. As discussed below, the Commission denies rehearing. This decision is in the public interest because it rejects a provision that could potentially permit undue discrimination among shippers.

Background

On July 2, 2001, ANR filed three negotiated rate agreements between ANR and BG&E for transportation service, under Rate Schedule FTS-1, with a July 1, 2001 effective date. The agreements contain a provision giving BG&E the option to either reduce its maximum daily quantity (MDQ) or buy out of the contract in whole or part in the event any of its customers purchase supplies from another source and cause BG&E's annual gas sales volumes to decrease by an amount greater than 10 percent. The right to reduce MDQ may only be exercised once every 12 months and in no event shall the sum of the reductions exceed 30 percent of BG&E's total contract demand. If BG&E exercises the right to reduce MDQ, the rate in these service agreements would be adjusted

¹ANR Pipeline Co., 96 FERC ¶ 61,183 (2000).

to a rate that would provide ANR with the same annual revenues that ANR would have earned prior to the MDQ reduction. If BG&E exercises its buyout right, it must pay ANR the net present value of the revenues to be earned by ANR under the agreements. In addition, the agreements contained a provision giving BG&E a right of first refusal (ROFR), notwithstanding the fact that the shipper would otherwise have been ineligible for this right under Section 22.2 of ANR's General Terms and Conditions (GT&C).

The Commission determined that the MDQ reduction and rate adjustment provisions are material deviations from ANR's pro forma service agreement. The Commission believed that these types of provisions are in effect negotiating terms and conditions of service. The Commission explained that allowing these type of provisions to occur in a negotiated rate agreement, which is not available to all shippers, would be unduly discriminatory and preferential. Nevertheless, the Commission accepted and suspended the agreements, to be effective July 1, 2001, subject to ANR demonstrating that it could not provide the services under a generally applicable rate schedule developed consistent with other aspects of its tariff. The Commission directed ANR to file an explanation or file revised service agreements, with the provisions removed, by September 17, 2001.

Additionally, the Commission directed ANR to file an explanation as to why the agreements contain a provision stating that the shipper will have a right of first refusal, "notwithstanding the fact that Shipper would otherwise be ineligible for this right under Section 22.2." The Commission noted that BG&E is eligible for the right of first refusal currently in section 22 of ANR's General Terms and Conditions, and therefore the provisions would appear to be unnecessary.

Request for Rehearing

ANR and BG&E argue the Commission should have accepted the MDQ Reduction and Buyout provisions as part of a negotiated rate agreement. BG&E explains that the MDQ Reduction and Buyout provisions would allow it to reduce either its MDQ or buyout the agreements in the event that any of its customers purchase gas supplies from another source and, as a result, its annual gas sale volumes decrease by an amount greater than 10 percent. It asserts that these provisions are crucial to effective and efficient operation of its retail gas unbundling program and were the product of give-and-take negotiations. ANR and BG&E argue the Commission erroneously treated these provisions as negotiated terms and conditions of service instead of finding that the provisions were appropriately included in a negotiated rate agreement.

They contend that this treatment is contrary to the Commission's policy and precedent regarding negotiated rates and negotiated terms and conditions and the

Commission's only explanation for not accepting the agreements without condition is that the provisions are unduly discriminatory and preferential because they are not available to all shippers. They believe this rationale is incorrect in light of the statement in Order No. 637 which provides that:

[a] negotiated rate would not include conditions or activities related to the transportation of gas on the pipeline, such as scheduling, imbalances, or operational obligations such as OFOs. By contrast, negotiated rate agreements can include the price, the term of service, the receipt and delivery points, and the quantity.²

The parties argue that the MDQ Reduction and Buyout provisions are not negotiated terms and conditions of service because they do not affect ANR's systems, nor do they harm any other shipper. The parties state that pipelines' Forms of Service Agreements generally include blank spaces for the insertion of price, term of service, receipt and delivery points and MDQ. They believe the Commission's reference in Order No. 637 to these terms as properly includable in negotiated rate agreements has been interpreted in subsequent cases to mean that provisions addressing these terms in a manner that may deviate from the Form of Service Agreement are also includable in negotiated rate agreements.

The parties argue that the Commission has accepted the type of provision at issue here in other cases as a part of negotiated rate agreements³ and that these cases

²Order No. 637, Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, FERC Stats & Regs. ¶ 31,091 at 31,343-44 (2000).

³See Tennessee Gas Pipeline Co., 87 FERC ¶ 61,206 (1999) (Commission expressly rejected the contention that a buyout provision represented a prohibited negotiated term and condition because the shipper agreed to pay a negotiated rate in exchange for the ability to terminate service early, finding the provision would not change the character of the service provided or the operational conditions of service); Tennessee Gas Pipeline Co., 89 FERC ¶ 61,033 (1999) (Commission approved provisions that allowed a shipper to either terminate its agreement to reduce its MDQ obligation in specified amounts, at specified times, or upon specified conditions and found that the agreements reflected that the shipper is willing to pay a negotiated rate in order to have the ability terminate or reduce the contract level; see also Tennessee Gas Pipeline Co., 91 (continued...)

established that non-rate provisions, such as the MDQ Reduction and Buyout provisions, that were negotiated in exchange for a rate are properly considered negotiated rate provisions and not negotiated terms and conditions. They believe the financial mechanisms, built into contracts to provide shippers with service flexibility and to protect the shippers from financial risk (such as the inability to terminate or reduce purchases under a contract) do not constitute a term and condition of service.

In response to the Commission's finding that the provisions are a material deviation from ANR's Form of Service Agreement, the parties argue that, while the provisions clearly deviate from the pro forma agreement, this question is not germane to the resolution of these proceedings because such a determination is relevant only to whether ANR was required to file the agreements, and that ANR in fact did file the agreements on July 2, 2001. They state that, if the Commission intended that all material deviations are unduly discriminatory and can be provided only upon a demonstration that such provisions cannot be provided under a generally applicable rate schedule, such a finding would equate the concepts of material deviations and negotiated terms and conditions and would be superfluous.

The parties argue that the Commission is applying what is essentially a new policy to existing contracts. The parties assert they reasonably relied on Commission policy that existed at the time and that, if the Commission refuses to alter its findings on rehearing, the Commission should acknowledge that it is adopting a new policy governing pipeline contract practices and apply it prospectively only.

Finally, ANR and BG&E argue that the Commission should find that the ROFR provision is not a material deviation. ANR states that negotiated rate agreements entered into after the effective date of Order No. 637 are not eligible for a ROFR but that in its Order No. 637 proceeding, it has filed pro forma tariff sheets to implement the Commission's new ROFR rules, including the statement that negotiated rate agreements are not eligible for ROFR unless ANR and the shipper agree otherwise. Since the agreements between BG&E and ANR would be filed as negotiated rate agreements, the parties were not certain about the effect of Order No. 637 on the applicability of a regulatory right of first refusal to the agreements. ANR and BG&E state that the ROFR provision in their negotiated rate contracts is necessary to clarify that, once ANR's Order

³(...continued)

FERC ¶ 61,292 (2000) (bids with termination options must be classified as negotiated rate transactions); Kern River Gas Transmission Co., 94 FERC ¶ 61,161 at 61,584 (2001) (contracts to clarify the events which would allow the shipper to reduce its MDQ and the manner in which the reduction would be effected are acceptable).

No. 637 tariff language is implemented, BG&E will continue to have a contractual ROFR. Consequently, ANR requests the Commission to find that the contractual ROFR is a provision addressing the term of the contract and is not a material deviation under Order No. 582. BG&E explains that a right of first refusal is necessary to guarantee that it will have adequate firm interstate storage and transportation capacity to serve its supply customers.

Discussion

A. MDQ Adjustment and Buyout Provisions

ANR and BG&E do not contest the Commission's finding that the MDQ reduction provision, combined with the buyout provision, constitute a material deviation from the Form of Service Agreement. Therefore, they agree that § 154.1(d) of the Commission's regulations required the filing of their service agreements.

In the letter order, once we found that the MDQ adjustment and Buyout provisions were material deviations from the tariff and the Form of Service Agreement, we then directed ANR, within 20 days of the issuance of the letter order, to demonstrate that the service could not be provided under a generally applicable rate schedule developed consistent with other aspects of its tariff or to file revised agreements without the non-conforming provisions. On rehearing, ANR and BG&E contend that this effectively treated the MDQ adjustment and Buyout provisions as negotiated terms and conditions of service of the type Order No. 637 refused to authorize. In essence they argue, the Commission has equated material deviations with negotiated terms and conditions of service. However, ANR and BG&E contend that Order No. 637 defined negotiated terms and conditions of service more narrowly to involve only matters related to operational conditions of transportation service on the pipeline. They argue that the level of a customer's MDQ and the buyout of the contract do not relate to operational conditions, and therefore the provisions at issue here should be considered negotiated rates. They point out that section 30 of ANR's General Terms and conditions authorize it to negotiate rates. For the reasons discussed below, the Commission denies ANR's request for rehearing.

Once a service agreement has been found to materially deviate from the Form of Service Agreement and the tariff so that it must be filed for Commission review, the question then becomes whether the Commission should approve the non-conforming provisions between ANR and BG&E containing the material deviation. As the Commission determined in the contemporaneous order being issued in Docket No. GT01-25-001, material deviations from the Form of Service Agreement fall into two general categories -- those that must be prohibited because they present a significant potential for

undue discrimination among shippers and those that can be permitted without substantial risk of undue discrimination.

One category of material deviation that is generally not permitted is negotiated terms and conditions of service. The Commission determined in Order No. 637 not to provide pipelines with the authority to file for preapproval of the right to negotiate terms and conditions of service with individual customers, because of the risk of undue discrimination among customers. In Order No. 637, the Commission stated that it generally considers negotiated terms and conditions to be related to operational conditions of transportation service. Order No. 637 gave as examples of such conditions, "scheduling, imbalances, or operational obligations such as OFOs."⁴ Subsequently, the Commission has held that negotiated terms and conditions of service include any provisions that result in a customer receiving a different quality of service than that provided other customers under the pipeline's tariff⁵ or that affect the quality of service received by others. An example would be where a pipeline's tariff requires all customers to maintain uniform hourly flows but the pipeline negotiates a special provision allowing one customer to deviate from the tariff's uniform hourly flow requirements. Consistent with Order No. 637, where a material deviation in a non-conforming contract constitutes a negotiated term and condition of service, the Commission would require that the pipeline modify its tariff to offer the negotiated service to all its customers or explain why it can only provide the service to this one customer.

However, not every material deviation from a pro forma Form of Service Agreement entails such a risk of undue discrimination that it cannot be permitted. For example, the Commission has permitted pipelines to negotiate rates that deviate from those that are set forth in the pipeline's generally applicable rate schedules, so long as the shipper continues to have the option of choosing recourse service from the pipeline.⁶ In Order No. 637, the Commission stated that permissible "negotiated rate agreements can include the price, the term of service, the receipt and delivery points, and the quantity."⁷

⁴Id.

⁵See Dominion Transmission, Inc., 93 FERC ¶ 61,177 (2000).

⁶Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, 61 Fed. Reg. 4633 (February 7, 1996), 74 FERC ¶ 61,076 (1996).

⁷Order No. 637, III FERC Stats & Regs. ¶ 31,300 at 31,344.

However, as the policy statement on alternatives to traditional ratemaking emphasized, "the predicate for permitting a pipeline to charge a negotiated rate is that capacity is available at the recourse rate."⁸ Therefore, as discussed further below, a key factor is determining whether to approve a material deviation agreed to as part of a negotiated rate agreement is the extent to which the option of obtaining service at the recourse rate is an adequate alternative.

In addition, there are other material deviations that may be negotiated with an individual shipper to address its unique characteristics, without affecting the quality of service received by that shipper or others. For example, the Commission recently approved a provision in a service agreement with a limited partnership that exculpated the individual partners from liability for the actions of the partnership.⁹ The partnership agreement required this provision in all material contracts it entered into.

Applying the above analysis to the contract in this case, the Commission finds that the MDQ adjustment provision presents too much potential for undue discrimination, unless it is offered in ANR's tariff pursuant to generally applicable conditions. We recognize that ANR has stated that it cannot offer all its customers the same rights to reduce or buyout their contract demand, and it desires to tailor such provisions to the circumstances of individual customers. However, ANR's explanation of how it has negotiated more narrowly drawn rights to reduce contract demand with customers who have larger contract demands only increases our concern about the potential for undue discrimination in the offering of contract adjustment rights. It is clear that ANR has negotiated quite different contract demand reduction rights with different customers. A shipper's right to reduce, or terminate, its contract demand before the expiration of its contract is a valuable right, since it can enable the shipper to avoid significant liability for future reservation charges. Such a valuable right must be granted in a not unduly discriminatory manner.

While a pipeline may place reasonable conditions on the negotiation of contract demand reduction rights,¹⁰ such conditions must not be unduly discriminatory. The

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⁸74 FERC at 61,241.

⁹ANR Pipeline Co., 97 FERC ¶ 61,075 (2001).

¹⁰For example, it may be reasonable for a pipeline to tie contract demand reduction rights to certain events, such as the closure of the plant being served by a
(continued...)

Commission finds that requiring pipelines to file generally applicable tariff provisions setting forth the conditions under which they will offer contract demand reduction rights is the best means of assuring that those rights will be negotiated in a not unduly discriminatory manner. Such a tariff filing would give the Commission and other interested parties an opportunity to review the circumstances in which the pipeline will offer contract demand reduction rights. Also, once approved, the tariff provision will require the pipeline to grant similar rights to similarly situated customers.

As ANR and BG&E point out, in two cases involving Tennessee Gas Pipeline Co. (Tennessee),¹¹ the Commission held that provisions permitting the termination or reduction of service could be negotiated as part of negotiated rate agreements. The Commission treated those provisions as covering the rate and the term of the agreement, matters that it concluded could be negotiated under the Commission's negotiated rate policy. However, the Commission has reconsidered that holding and, in a contemporaneous order on rehearing in Tennessee, is changing the policy stated in the earlier Tennessee orders.

It is true, as Order No. 637 stated, that negotiated rate agreements can include not only the price, but also the term of service, the receipt and delivery points, and the quantity. Such provisions are necessary to define the service to be received at the negotiated rate. However, it does not follow that the Commission should permit contract demand reduction or termination provisions to be negotiated as part of negotiating the contract term or quantity to be included in a particular service agreement. The linchpin of the Commission's negotiated rate policy is that a customer not satisfied with the negotiated rate offered by the pipeline for the amount of service requested by the shipper can always obtain available capacity at the Commission-determined just and reasonable recourse rate. Where a customer is seeking service for a set contract term and quantity, the recourse service does provide an adequate alternative. If a mutually agreeable rate cannot be agreed upon, the shipper can always obtain the same service at the recourse rate for the same contract term and quantity. However, if the customer desires a special contract demand reduction or early termination right not provided in the generally applicable tariff, the availability of service at the recourse rate does not provide an adequate substitute, since recourse service would not include any such provision. This

¹⁰(...continued)

particular contract or, in the case of an LDC, a loss of customers through retail unbundling or a bypass.

¹¹87 FERC ¶ 61,206 (1999), rehearing pending. 89 FERC ¶ 61,033 (1999), rehearing pending.

reinforces our conclusion that pipelines should not be permitted to negotiate such provisions, unless they are offered, subject to reasonable conditions, as part of the pipeline's generally applicable tariff.

Since ANR currently has no tariff provision offering contract demand adjustment provisions on a not unduly discriminatory basis, the Commission disapproves the contract demand adjustment provision in the subject contract with BG&E and requires that it be removed from the contract. If ANR wishes to offer such provisions to a shipper, it may file a tariff provision proposing the non-discriminatory conditions pursuant to which it proposes to offer such provisions.

B. Right of First Refusal

The agreements with BG&E also provide that BG&E would have a right of first refusal under Section 22 of the GT&C of ANR's tariff, "notwithstanding the fact that BG&E would otherwise have been ineligible for this right under Section 22.2." The Commission directed ANR to explain why BG&E is not currently eligible for a regulatory right of first refusal under its current tariff, which continues to provide a ROFR to all firm shippers with contract terms of a year or more. In response, ANR points out that it has filed pro forma tariff language in its Order No. 637 compliance filing that would limit the ROFR to maximum rate shippers, unless ANR and a particular shipper agree otherwise. Under that language, negotiated rate agreements would be ineligible for the ROFR, absent an agreement otherwise. Since ANR's Order No. 637 filing has not yet been acted on by the Commission, under ANR's currently effective tariff, BG&E's negotiated rate agreements are currently eligible for the ROFR right. However, the contract provision is intended to clarify that even after approval of ANR's proposed tariff modification, BG&E will have a contractual ROFR. The Commission finds that such a clarification is acceptable.

The Commission orders:

(A) The request for rehearing is denied.

(B) Within 30 days of the date of this order, ANR must file a revised agreement with BG&E, removing the MDQ adjustment provision consistent with the above discussion.

By the Commission.

(S E A L)

Docket No. RP99-301-030

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David P. Boergers,
Secretary.